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Following the money

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If you want to catch a criminal or terrorist, does it make sense to "follow the money"? A "yes" answer makes sense if you can identify at least one of the individuals or institutions connected with the suspected wrongdoer. However, if you are trying to follow money flows in general or all money flows, it is not likely your work will be very productive, and it will also involve massive violations of civil liberties.

Back in the 1970s and '80s, law-enforcement agencies were having trouble catching and convicting major drug dealers. Some thought the solution might be to identify the criminal monetary proceeds of the drug dealers and then make it illegal to use or hide money from illegal activities — i.e., money laundering. The result was the Money Laundering Control Act of 1986 that, for the first time, made money-laundering illegal. There have been a number of subsequent laws aimed at strengthening the anti-money laundering regulations, including last year's "Patriot Act."

Money laundering is not an easy crime to define or detect since an almost infinite number of assets are "fungible" — that is, can be readily turned into money and vice versa.

As an example, let us say Joe is a drug dealer in London. Every day he collects \$10,000 in cash from selling drugs. As a cover, he has a fish-and-chips shop in London that is a cash business, and so he commingles his drug money with his legitimate fish-and-chips receipts and makes a daily bank deposit. To the bank, it appears that Joe has a nicely profitable fish-and-chips business just like thousands of others of profitable cash businesses the bank deals with.

Joe needs to pay his drug supplier, Han, who operates a toy export business out of Hong Kong (in which he smuggles the drugs). If Joe sends money to Han's account in Hong Kong that could be noticed by authorities if there is no invoice for a product or service. So Joe arranges to buy a painting for a \$100,000 from an associate of Han's in Hong Kong. In fact, the painting only cost Han a few hundred dollars (which Joe, of course, knows), because art values are subjective, who is to say the painting is not worth a \$100,000 to Joe?

There are infinite numbers of variations of such schemes, which are most difficult for law-enforcement officers to distinguish from totally legitimate business operations. If the police suspect Joe or Han of drug dealing, it makes perfect sense to "follow the money," but just following money without knowing who might be involved in a crime is most often a waste of time and money. When the total costs to the banking system of the myriad anti-money-laundering reporting requirements are correctly measured, few anti-money laundering efforts are cost-effective.

Terrorism is now a top concern of governments as it ought to be. One of the responses has been trying to follow the terrorists' money and add more reporting requirements to banks under the anti-money-laundering regulations.

However, much of this makes no sense. Most terrorists' money comes from legal sources and is used for illegal acts, which is the opposite of criminals using illegally obtained money for legal acts.

Osama bin Laden is reported to be a wealthy man as a result of his family's construction and oil business, so the money may be legal but the use of it is not. We know terrorist activities are often funded through charities, by well-meaning people who think they are helping Arab children or some such, rather than funding terrorism. Again the money is legal, but its use is not.

Virtually all governments have the legal tools they need to get banks to give them transactions and account information on suspected criminals or terrorists. There are also extensive information-sharing agreements among governments for such specific suspicions.

However, there is now a major effort underway to do blanket (mass financial data on individuals who are not suspected of any illegal act) sharing of information between governments under the guise of fighting money laundering or terrorism. This effort is being driven by the Europeans who are more concerned about tax competition than terrorism. In fact, blanket information sharing will make us less safe because all governments leak information, and personal financial information has great value to criminals and terrorists.

Law-enforcement dollars, like all other dollars, are scarce and should be used where they will provide the most safety. Many money-laundering costs, particularly on the financial sector, have only increased the costs of banking for all of us and have not improved our safety. The government-to-government blanket financial information sharing schemes will make us poorer and a lot less safe.

The Treasury Department is responsible for financial information-sharing, and many of the anti-money-laundering efforts. It needs to do a far better job in measuring the total costs, including private-sector monetary costs, and the high probability of information leaks and abuse of these information-sharing and data-reporting schemes and regulations. Making the necessary changes should be a top priority for the new Treasury secretary.

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